

ORIGINAL

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY
Docket No. MC96-3

Special Services Fees and Classifications

ANSWERS OF THE OFFICE OF THE CONSUMER ADVOCATE
TO INTERROGATORIES OF UNITED STATES POSTAL SERVICE
WITNESS: ROGER SHERMAN (USPS/OCA-T100-19-22)
(OCTOBER 25, 1996)

The Office of the Consumer Advocate hereby submits the answers of Roger Sherman to interrogatories USPS/OCA-T100-19-22, dated October 11, 1996. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

Emmett Rand Costich

EMMETT RAND COSTICH
Assistant Director
Office of the Consumer Advocate

OCT 25 1996

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-19-22

USPS/OCA-T100-19. Please refer to page 4, line 2 of your testimony, where you refer to the pursuit of "equitable contributions to institutional costs."

a. Would you agree that, in postal ratemaking, the concepts of "fairness" and "equity" are essentially the same? If not, please explain fully.

b. In Docket No. R74-1, the Postal Service submitted the direct testimony of William Vickery, very recently announced as one of two winners of the 1996 Nobel Prize in Economics, in support of a Ramsey-type approach to pricing postal products. When asked if inverse elasticity pricing brings about a "fair distribution" of the revenue burden, Dr. Vickery responded:

Economists have no special expertise in deciding what is fair and what is not. For that you need a vicar, not a Vickery.

Docket No. R74-1, Vol. III (Part 1), pg. 77. Do you agree with these statements by Dr. Vickery? If not, please explain fully.

A. a. Yes, "fairness" and "equity" are very similar virtues. Since both words appear in statutory guidelines, the statute's authors may have presumed some differences.

b. Very few persons can claim to be expert in rendering what is fair, and no absolute expertness can be claimed by a group, such as economists (or perhaps even vicars). Some principles have been articulated to define fairness, however, and economists may play an instrumental role in analyzing these representations of fairness and interpreting their application.

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USPS/OCA-T100-20. Please refer to page 3, lines 10-12 of your testimony, in which you state that this case presents "an unusual proposal for making price increases on a piece-meal basis rather than in context, as in an omnibus rate case, where all rates for all services can be compared," and lines 16-21 of page 7, in which you state that "to see the pattern" of relative price relationships (such as Ramsey) prices "it is desirable to consider all prices at once, as in an omnibus rate case."

a. Please confirm that it is possible to compare all rates for all services at any time, whether one is proposing to change all rates, many rates, few rates, or no rates. If you cannot confirm, please explain fully.

b. Please confirm that it is possible to compare existing relative price relationships with those suggested by a Ramsey model or, for example, a uniform markup model, whether one is proposing (or even contemplating) a change in all rates, many rates, few rates, or no rates. If you cannot confirm, please explain fully.

A. a. Yes, it is possible to compare all rates for all services at any time. When only some new rates are proposed, however, the consequences to services that are not being altered may not be included and then the evaluation will be incomplete.

As I noted in my testimony (OCA-T-100, p. 8, lines 4-7),

It is still possible to consider effectively only a subset of services, if added care is given to the subset and effects of relations to other prices and services are included.

The added care seems to be lacking in this case, care to show the interrelations with other services and to compare cost coverages

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CONTINUATION OF ANSWER TO USPS/OCA-T100-20:

across all classes.

b. Confirmed. It is possible to compare existing relative price relationships, assuming all necessary data are available.

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USPS/OCA-T100-21. Please refer to page 9, lines 10-14 of your testimony, where you claim that it "stands to reason that increased prices for only some services will distort overall Ramsey price relationships or any other form of relative relationship from whatever existed before, unless attention is focused on services where price-cost relationships have fallen out of line."

a. Please confirm that this statement presupposes that, when rates were last changed, all rates were "in line" with Ramsey pricing or some other deliberate approach to establishing price-cost relationships. If you cannot confirm, please explain fully.

b. Would you agree that it may be possible to have a situation in which all rates were not "in line" at the time of the last rate change, and that rate changes "for only some services" may thus improve conformity rather than cause distortions? If you do not agree, please explain fully.

c. Would you agree, given a hypothetical situation in which price-cost relationships for a number of services are "out of line" (regardless of whether they were previously "in line" and fell out, or they were never "in line"), that it is better to move some (but not all) of those services in the direction of "in line" rather than leave them all where they are? Please explain your answer fully, discussing any factors that you believe might be relevant to qualify your response.

A. a. Confirmed. Presumably, with regard to price relationships, whatever existed before was approved and accepted.

b. I certainly agree that correcting those rates that have fallen out of line could improve conformity rather than cause distortions. That is essentially what is said in the sentence from page 9 of my testimony that is quoted at the beginning of this interrogatory. And in the next sentence I said:

But attention clearly is not focused in that way, since two money losing special services, C.O.D. and money orders, are not given any attention. (OCA-T-100, p. 9, lines 14-17).

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CONTINUATION OF ANSWER TO USPS/OCA-T100-21:

Thus, although it is possible that rate changes for only some services could improve conformity with pricing aims, evidence suggests that is not the purpose here.

While it make no difference to the argument, it would seem more reasonable to assume that approved rate changes were not "out of line," but that some may have fallen out of line since then, due to cost or demand changes.

c. See answer to b. A hypothetical example is unnecessary since C.O.D. and money order services appear to be priced below their attributable costs at present. Raising rates for only these two services, C.O.D. and money order, would thus appear to improve conformity with the pricing requirements of the Act. But such changes were not proposed.

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USPS/OCA-T100-22. Please refer to the bottom of page 5 and the top of page 6 of your testimony, where you discuss the fee for certified mail and your views of the implications of the fact that competitors currently offer comparable service at much higher prices.

a. Your claim that the Postal Service has "market power" is supported by quotation of a statement that identifies conditions to test for the presence of "monopoly power." In your view, are "market power" and "monopoly power" the same? If not, which do you believe applies to certified mail? Please explain your answers fully.

b. Please confirm that, according to the criteria for "monopoly power" quoted at lines 5-9 of page 6, the competitors of the Postal Service that charge much higher prices for comparable service must have monopoly power in the market because they have raised their prices far above the fees for Certified Mail without concern for the reactions of the Postal Service. If you cannot confirm, please explain fully.

c. Please confirm that the Postal Service cannot be "exploiting" its market power if other service providers continue in the market charging higher prices than those of the Postal Service, and customers continue to patronize those service providers. If you cannot confirm, please explain fully.

d. If a firm has market or monopoly power, does the imposition of any price increase constitute "exploitation" of that market or monopoly power? Please explain fully (distinguishing between the two types of power to whatever extent you believe to be relevant). If not, how does one distinguish a price increase that would constitute "exploitation" from one that would not? Please explain fully.

e. Please confirm that if a firm can raise its rates without concern "because its rivals cannot offer customers reasonable alternatives," the service in question must have a high "value of service" to its customers, as that term is used in postal ratemaking. If you cannot confirm, please explain fully.

f. Is it your testimony that, all other things being equal, a fee increase for Certified Mail would be more defensible if comparable services offered by competitors were available at equivalent or lower prices, rather than a higher prices? Please explain fully.

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ANSWER TO USPS/OCA-T100-22:

A. a. The words, "market power" and "monopoly power" are often used to represent the power to raise price. "Market power" is generally used when there is clearly more than one seller. In this situation, "monopoly power" could be used because the Postal Service is the dominant seller. Alternatively, monopoly power may effectively exist because other sellers' prices are so far above the Postal Service's that it alone is in position to raise price.

b. Not confirmed. Alternative or "fringe" providers of service may be handicapped by higher costs, and barely able to survive at their cost disadvantage.

c. Not confirmed. Higher priced providers of a service may often exist on the fringe of a monopoly service, offering different features and attracting some customers despite serious cost disadvantages.

d. No, nothing as simple as a price increase can identify monopoly exploitation. Ordinarily, one would expect a legal private monopoly (a monopoly based, say, on a patent) to exploit its position by choosing profit maximizing prices. The monopoly position is revealed by the high level of prices in relation to

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CONTINUATION OF ANSWER TO USPS/OCA-T100-22:

costs, not by changes in prices. A public enterprise with monopoly power may not fully use its power by setting profit maximizing price levels, because it is charged with serving the public. At any time it might be possible, however, for such an enterprise to exploit its monopoly situation in a particular market by raising its price there. Whether the price increase would be reasonable or exploitative would be determined by an evaluation of the overall pricing policies of the enterprise, which is most easily done, of course, in an omnibus rate case.

f. No, the problem in considering a fee increase for Certified Mail has little to do with the level of alternative prices. That they are high merely indicates that the Postal Service would seem to have market power that would permit it to increase price for Certified Mail. Whether price should be increased depends on cost coverages and value of service for this service relative to others, and on other pricing criteria.

DECLARATION

I, Roger Sherman, declare under penalty of perjury that the answers to interrogatories USPS/OCA-T100-19-22 of the United States Postal Service are true and correct, to the best of my knowledge, information and belief.

Executed

A handwritten signature in cursive script, appearing to read "Roger Sherman", is written over a horizontal line.

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document upon all participants of record in this proceeding in accordance with section 3.B(3) of the special rules of practice.

A handwritten signature in black ink, reading "Emmett Rand Costich". The signature is written in a cursive style with a large initial 'E'.

EMMETT RAND COSTICH
Attorney

Washington, D.C. 20268-0001
October 25, 1996